

HANDOUT 4.1

Why is Economic Freedom So Vitally Important?

ECONOMIC FREEDOM IS NOT THE SAME AS POLITICAL FREEDOM

Political institutions and economic institutions are not the same.

Political freedom measures whether individuals are able to determine who their rulers will be, and how they will be ruled. If individuals have access to free and fair elections, the country will have a high level of political freedom. When the winner of an election is able to peacefully take office, the political party process is competitive, the opposition is able to play a role and have power, and minority groups are well represented, then this is indicative of high levels of political freedom. Countries have low levels of political freedom when they are ruled by one-party or military dictatorships, religious hierarchies, or autocrats. When individuals are subject to government oppression and extreme violence, then they have little to no political freedom.

This differs from economic freedom, which is concerned with an individual's personal choice, voluntary exchange coordinated by markets,

freedom to enter and compete in markets, and the protection of people and their property from aggressors. Although most countries that rank high on the Economic Freedom of the World index are democracies, it is important to note that democratic political procedures do not guarantee economic freedom. This is because voters can (and often do) elect political leaders who pass laws that limit economic freedom. That being said, sometimes an autocratic regime can increase economic freedom.

HOW ECONOMIC FREEDOM RELATES TO MEASURES OF WELL-BEING

Since 1980, increases in economic freedom have been associated with increases in people's economic well-being, living standards, and life satisfaction. Among the measurements where more economically free countries outperform less economically free countries are:

+ Income per person (GDP per capita)

In 2015, nations in the top quartile of economic freedom (the most economically free

nations) had an average income per person (GDP per capita) of \$42,463, while nations in the bottom quartile (least economically free) had an average income per person of \$6,036 (PPP constant 2011 US dollars). This means the average person in the most-free quartile is about 7 times as wealthy as the average person in the least-free quartile.

See **Exhibit 1.11** in the *Economic Freedom of the World: 2017 Annual Report*

+ Economic growth

Between 1990 and 2015, nations in the top quartile of economic freedom had an average growth rate (%) of GDP per capita of 3.35%, compared to 1.66% in the least free quartile (PPP constant 2011 US dollars).

See **Exhibit 1.12** in the *Economic Freedom of the World: 2017 Annual Report*

+ Average income of the poorest 10% of the population

In 2015, the average income of the poorest 10% of the population in the most-free quartile was \$11,998, compared to \$1,124 for the poorest 10% of the

population in the least-free quartile (PPP constant 2011 US dollars). This means economic freedom isn't only beneficial for the well off, but that more economic freedom also benefits the poorest of the poor in a country! Moreover, note that the average income of the poorest 10% of the population in the most-free quartile (\$11,998) is nearly double that of the average income of the population as a whole in the least-free quartile (\$6,036).

See **Exhibit 1.14** in the *Economic Freedom of the World: 2017 Annual Report*

+ Extreme and Moderate Poverty Rates

The extreme poverty rate is the percentage of a country's population that lives on \$1.90 per day (PPP constant 2011 US dollars). In 2015, the most-free quartile had less than 1 percent of its population (0.98%) living at the extreme poverty rate. Contrast that with countries that fall within the least-free quartile, which had on average 30.34% of their population living at the extreme poverty rate. The moderate poverty rate is the percentage that lives on \$3.10 per day (PPP constant 2011 US dollars). In 2015, the most-free quartile had 2.26% of its population living at the moderate poverty rate, while the least-free quartile had nearly half of its population (48.90%) living at the moderate poverty rate.

This tells us that extreme and moderate poverty has been nearly eradicated in countries with high levels of economic freedom.

See **Exhibit 1.15** in the *Economic Freedom of the World: 2017 Annual Report*

+ Life Expectancy

Life expectancy is about 80.7 years for individuals living in nations that are in the most-free quartile, while life expectancy for those in the least-free quartile is only about 64.4 years. This means life expectancy is about 16 years longer in countries with the most economic freedom than in countries with the least. Those additional 16 years could mean the difference between living long enough to get to know one's grandchildren or not.

See **Exhibit 1.16** in the *Economic Freedom of the World: 2017 Annual Report*

+ Political Rights and Civil Liberties

Freedom House measures political rights and civil liberties on a scale from 1 to 7, where 1 is the highest degree of political rights and civil liberties and 7 is the lowest. In 2015, countries in the most economically free quartile had on average a political rights score of 1.7 and a civil liberties score of 1.6, while countries in the least economically free quartile had a political liberties score of 4.5 and a civil liberties score of 4.4.

Remember, when it comes to the scoring of political rights and civil liberties by Freedom House, the closer a country is to a score of 1, the more political rights and/or civil liberties it has, which means greater economic freedom is associated with more political rights and civil liberties.

See **Exhibit 1.16** in the *Economic Freedom of the World: 2017 Annual Report*

+ Gender Inequality

The UN's Gender Inequality index measures gender-based disadvantage in three dimensions: reproductive health, empowerment, and the labour market. The reproductive health dimension has two indicators, the maternal mortality ratio and the adolescent fertility rate. The empowerment dimension of the index is measured by two indicators, the share of parliamentary seats held by each sex, and higher education attainment levels. The labour market dimension is measured by women's participation in the workforce. Together, these three dimensions comprise the Gender Inequality Index (GII). The index ranges from 0 to 1, 0 representing 0% inequality where women and men fare equally, and 1 representing 100% inequality, indicating women fare poorly compared to men. Countries in the most economically free quartile

scored an average of 0.139 on the Gender Inequality index, and countries in the least economically free quartile scored an average of 0.506. This means men and women tend to fare equally in countries with greater economic freedom.

See **Exhibit 1.18** in the *Economic Freedom of the World: 2017 Annual Report*

+ **Happiness**

The UN's World Happiness index has a life evaluation question that asks the respondents to rate their own current lives on a 0 to 10 scale, where the best

possible life is a 10 and the worst possible life is a 0. Individuals living in countries that are in the most economically free quartile answered 6.70 on average, while individuals living in countries that are in the least economically free quartile answered 4.61 on average. This means that people in countries with greater economic freedom tend to be happier about their lives.

See **Exhibit 1.19** in the *Economic Freedom of the World: 2017 Annual Report*